S239958

No.__________

IN THE SUPREME COURT OF THE STATE OF CALIFORNIA

CAL FIRE LOCAL 2881
(formerly known as CDF Firefighters), *et al.*,

Petitioners and Appellants,

v.

CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM
(CalPERS) *et al.*,

Respondent,

and

THE STATE OF CALIFORNIA,

Intervenor and Respondent.

SUPREME COURT
FILED
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Court of Appeal of the State of California
First Appellate District, Division 3
Case No. A142793

Appeal from Superior Court of California, County of Alameda
The Honorable Evelio Grillo, Presiding Judge
Civil Case No. RG12661622

PETITION FOR REVIEW

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I

ISSUES FOR REVIEW

Following this Court's grant of review on November 22, 2016, in *Marin Association of Public Employees, et al. v. Marin County Employees' Retirement Association, et al.* (2016) 2 Cal.App.5th 674 (California Supreme Court, Case No. S237460) ("*Marin Public Employees*"), this petition raises complimentary—and equally important—questions concerning how statutory pension benefits become vested and the extent to which they may be modified or eliminated; specifically:

1. Does the Contracts Clause of the California Constitution prevent the Legislature from eliminating a statutory pension benefit without providing employees with offsetting comparable new advantages?
2. Does a statute which provides a pension benefit enjoy contracts clause protections only if it expressly provides that the benefit cannot be modified or eliminated?
3. Is the option to purchase additional service credits a vested pension benefit?

II

REASONS FOR GRANTING THE PETITION

Review of the opinion below by the Court is necessary to secure uniformity of decision concerning California's vested pension rights

doctrine. (Cal. Rules of Court, rule 8.500(b)(1).) In a sharp break from this Court's longstanding jurisprudence protecting public employee pension rights, the opinion below affirms the Legislature's unilateral elimination of the right of *existing* state and local government employees to purchase additional service credit under Government Code section 20909 ("section 20909").[1] From 2004 until the date it was repealed on December 31, 2012, section 20909 permitted qualifying employees to increase the service component of their final pension by purchasing additional service credit. CalPERS, the nominal defendant in this case, agrees with Petitioners that section 20909 created vested contract rights for existing employees. (Slip op. at p. 10.)

Like *Marin Public Employees*, with which it unreservedly casts its lot, the lower court makes a frontal challenge to the "California Rule." Petitioners relied on this Court's longstanding vested rights jurisprudence (slip op. at pp. 5, 7 and 14, acknowledging Petitioners' reliance on *Kern v. City of Long Beach* (1947) 29 Cal.2d 848, *Betts v. Board of Administration of Public Employees' Retirement System* (1978) 21 Cal.3d 859 and *Allen v. City of Long Beach* (1955) 45 Cal.2d 128), but the court below rejected it in favor of the revised theory put forward in *Marin Public Employees* that

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[1] All statutory references are to the Government Code unless stated otherwise.

governing entities have *carte blanche* to eviscerate public employee pension benefits to a point short of destruction. (Slip op. at pp. 10-12.) For the same reasons the Court granted review in *Marin Public Employees*, it should do so here.

Attempting to buttress its holding (recognizing, presumably, this Court's grant of review in *Marin Public Employees*), the lower court held that section 20909—a statute within a broad pension law scheme (Public Employees' Retirement Law, § 20000 *et seq.*)—created neither a pension benefit nor a vested contractual right. It did so by reading new restrictions on the creation of vested pension rights from this Court's ruling in *Retired Employees Assn. of Orange County, Inc. v. County of Orange* (2011) 52 Cal.4th 1171. *Retired Employees Assn.* unanimously affirmed that *implied* vested retiree health benefits for public employees can be created under California law, so long as clear evidence of a legislative intent to create such rights exists. (*Id.* at pp. 1189-1190.) The Court stressed the higher burden one seeking to establish such rights *by implication* faces. (*Id.*) Yet the court below applied those same standards to the *express* benefit created by section 20909, superimposing the obligation that the statute "unambiguously state[] an intent by the Legislature to create a vested pension benefit." (Slip op. at p. 9, citing *Retired Employees Assn.*, at p. 1190.) The lower court suggested that a pension statute does not create a

vested right unless it contains a "promise by the Legislature *not to modify or eliminate*" the benefit. (Slip op. at p. 9 [italics in original].)

This highly restrictive reading of how vested pension rights are created conflicts with decades of case law. For example, the statutes that were modified in *Betts v. Board of Administration of Public Employees' Retirement System,* 21 Cal.3d 859 and *Olson v. Cory* (1980) 27 Cal.3d 532—to name two of many cases—did not explicitly state that vested rights were created or that the Legislature could not modify or eliminate the benefits. Nonetheless, in each case this Court invalidated, on vested rights grounds, attempts by the Legislature to eliminate pension benefits created by statute. (*Betts*, 21 Cal.3d at pp. 867-868 [invalidating statutory amendment that withdrew pension benefits from legislators]; *Olson v. Cory,* 27 Cal.3d at p. 541 [invalidating new statute limiting cost-of-living increases for retired judges].) This Court should grant review and reaffirm that its ruling in *Retired Employees Assn.* clarified but did not break from its prior jurisprudence with respect to legislative enactments pertaining to pension benefits enjoying contractual protections. (*Olson*, 27 Cal.3d at p. 538 ["When agreements of employment between the state and public employees have been adopted by governing bodies, such agreements are binding and constitutionally protected."], quoting *Sonoma County Organization of Public Employees v. County of Sonoma* (1979) 23 Cal.3d 296, 304.)

Finally, this Court should grant review of the lower court's determination that only pension benefits that meet its narrow definition of "deferred compensation" are constitutionally protected. That flies in the face of countless cases which protect, as vested, employees' rights ranging from: required levels of employer contributions disability retirement benefits, sabbaticals, and even supplemental cost of living adjustments based on how well a retirement system's investments perform.

III

FACTUAL AND PROCEDURAL BACKGROUND

Petitioners are state employees and their labor union whose pension benefits are administered by the California Public Employees' Retirement System ("CalPERS"). They sued in early 2013, after the Legislature eliminated Government Code section 20909, a pension statute, which had formerly allowed state and local employees to purchase additional service credit. Petitioners alleged that the elimination of section 20909 violated the Contracts Clause. The lawsuit did not challenge the Legislature's right to eliminate the statute for *future* employees.

A. The Creation In 2004 Of The Right Of Qualifying Employees To Purchase Additional Service Credit

CalPERS is a public pension system, established under section 20000, *et seq.*, which defines its pension benefits exclusively by statute. (Slip. op. at p. 2.) CalPERS must administer benefits and discharge its

duties solely in the interest of plan participants and their beneficiaries. (Cal. Const. Article XVI, § 17(b).)

The right to purchase service credits was offered initially in 2004, when section 20909 was enacted, and remained available until December 31, 2012. It permitted a "member who has at least five years of credited state service" to make a one-time purchase of "not less than one year, nor more than five years, in one-year increments, of additional retirement service credit in the retirement system ... at any time prior to retirement." (§ 20909(b).)

The opportunity to purchase the additional service credits provided advantages to employees:

> Being able to purchase [additional service credits] allows members of CalPERS to increase their retirement benefits at no cost to employers. Many members take breaks in employment to raise children, advance their educations, or work in the private sector for a time. For members who do not enter CalPERS covered employment until later in life or who have breaks in service, purchasing [additional service credits] may contribute to providing a livable retirement income.

(JA at pp. 260, 266 & 271-272.) Thus, an employee might take five years off for the purpose of improving his/her education, for child care, or for providing healthcare for a relative, or plan to do so in the future and rely upon this statute to allow the employee to retire without loss of time or pension benefits. Because pension benefits are based on length of service

and compensation, without the statute, employees who took such leave would suffer a reduced pension.

The entire cost of the benefit, if exercised, was borne by the employee, who was required to "contribute 'an amount equal to the increase in employer liability, using the pay rate and other factors affecting liability on the date of the request for costing of the service credit.'" (Slip op. at p. 2, citing § 20909, subds. (a), (b); § 21052.) The "increase in employer liability" was calculated as the "present value of the projected increase in liability to the CalPERS system." (§ 21052; AB 719, Bill Analysis, p. 2 (Aug. 18, 2003).)

Among the putative class members were one firefighter who missed eligibility to purchase the service credits by 16 days (JA at pp. 158, 164), and others who had provided five years of service and planned to purchase additional service credits but were financially unable to do so before December 31, 2012. (JA at pp. 157-158.)

B. CalPERS Recognized That The Right To Purchase Additional Service Credit Was A Vested Right

CalPERS agreed with Petitioners that section 20909 created vested rights. Its publication "Vested Rights of CalPERS Members: Protecting the Pension Promises Made to Public Employees," was published in July 2011, widely read, and remained on its website, unaltered, until at least December 21, 2016.

CalPERS recognized that the right to purchase additional service credits vests immediately when offered:

> RULE 1:
>
> Employees Are Entitled To Benefits In Place During Their Employment
>
> Public employees obtain a vested right to the provisions of the applicable retirement law that exist during the course of their public employment. Promised benefits may be increased during employment, but not decreased, absent the employees' consent. *These rules apply to all active CalPERS members, whether or not they have yet performed the requirements necessary to qualify for certain benefits that are part of the applicable retirement law. For example, even if a member has not yet satisfied the five year minimum service prerequisite to receiving most service and disability benefits, the member's right to qualify for those benefits upon completion of five years of service vests as soon as the member starts work.*

(JA at p. 229, emphasis added.) More specifically, CalPERS described the right to purchase service credit as one of eleven vested rights:

> "Purchase service credit under the terms that existed in the law when they provided service, if the member satisfies all eligibility requirements."

(JA at p. 234.) Individual petitioners' reliance on the future ability to purchase was also set forth in the record. (JA at p. 160.)

C. The Legislature Repeals Section 20909, As Part Of PEPRA, And Petitioners File Suit

On January 1, 2013, section 7522.46 became effective as part of the Public Employees' Pension Reform Act of 2013 ("PEPRA"). PEPRA made significant changes to public employee pensions, primarily for *future*

employees, including reducing pension formulas for new hires. (See Legis. Counsel's Dig., Assem. Bill No. 340 (2011-2012 Reg. Sess.).) But section 7522.46 repealed section 20909 as it applied to *existing* employees as well.

Petitioners sued in the Superior Court of Alameda County seeking to compel CalPERS to allow future purchases of service credits for qualifying employees employed as of December 31, 2012. (JA at p. 166.) CalPERS declined to defend the legislation, so Respondent State of California intervened, unopposed, to defend it.

The trial court held a hearing on the petition on February 24, 2014. Several months later, on May 12, 2014, the trial court issued a final order; then, on June 5, 2014, an amended final order, both denying the petition. The trial court entered judgment on June 19, 2014.

D. The Court Of Appeal Holds That Pension Reductions Need Not Be Offset By Comparable Benefits So Long As Employees Retain A "Reasonable" Pension

On appeal, Petitioners relied on this Court's longstanding vested rights jurisprudence. (AOB at pp. 11-12.) The State did not contest that body of law, but argued that the right to purchase service credits was a mere "option," not a pension benefit. (State's Br. at p. 13.) It reasoned that if the employee bore the cost of the benefit, it could be characterized as neither deferred compensation nor a pension benefit, and consequently the Legislature could freely repeal the statute. (*Id.* at p. 15.) Oral argument occurred on December 21, 2016.

On December 30, 2016, the court of appeal issued its opinion and rejected Petitioners' claims on several bases. First, it faulted section 20909 for failing to "unambiguously state[] an intent by the Legislature to create a vested pension right." (Slip op. at p. 9, citing *Retired Employees Assn.,* 52 Cal.4th at p. 1190.) Without such a statement, reasoned the court, the Legislature's "continuing government power" allowed it to eliminate the benefit. (Slip op. at pp. 7-9.)

Second, accepting for the sake of argument that vested pension rights were created, the lower court held that "California law is quite clear that the Legislature may indeed modify or eliminate vested pension rights in certain cases." (Slip op. at p. 10.) The lower court cited older decisions of this Court for the proposition that the "government entity providing the pension may make reasonable modifications and changes in the pension system … [t]o maintain the integrity of the system and carry out its beneficent purpose." (Slip op. at p. 10, quoting *Kern v. City of Long Beach* (1947) 29 Cal.2d 848, 854-855 and citing *Wallace v. City of Fresno* (1954) 42 Cal.2d 180 and *Packer v. Board of Retirement* (1950) 35 Cal.2d 212.) But when it confronted the critical additional component of pension law—that "*changes in a pension plan which result in disadvantage to employees should be accompanied by comparable new advantages*" (slip op. at p. 11, quoting *Betts*, 21 Cal.3d at 864 [italics in the original])—the lower court fell back on *Marin Public Employees* and all the controversial aspects of

that opinion, including the view that so long as pension reductions do not destroy a public employee's pension, the Legislature is not foreclosed by the Contracts Clause from making modifications. (Slip op. at p. 12, n. 5, and pp. 13-16.)

Third, it accepted the State's argument that any purchase of service credits under section 20909 was not deferred compensation and therefore was not a pension benefit. (Slip op. at p 13.) Despite the statute requiring that employees provide five years of service, the Court concluded that the benefit was "wholly unrelated" to service. (*Id.*)

IV

DISCUSSION

A. Review Should Be Granted Because The Court Of Appeal Decision Relies Extensively On The Same Flawed Rationale As *Marin Public Employees*

This Court should grant review and decide this case together with *Marin Public Employees*. Alternatively, it should grant review and hold the opinion until *Marin Public Employees* is decided.

While the court below proffered that its ruling against Petitioners is not radical (slip op. at p. 10 ["California law is quite clear that the Legislature may indeed modify or eliminate vested pension rights in certain cases"]), ultimately it adopted *Marin Public Employees* as follows:

- reductions in promised pension benefits can occur without the obligation to provide offsetting comparable advantages (*id.* at p. 12, n 5);
- any changes short of "'destroying' an employee's anticipated pension" are permissible (*id.*);
- where this Court and other appellate courts have used the term "must"—as in "any modification of vested pension rights ... when resulting in disadvantage to employees, *must* be accompanied by comparable new advantages" (*Allen v. Board of Administration* (1983) 34 Cal.3d 114, 120)—they meant "should," a term which shoulders no legal obligation (*id.* at pp. 14-15);
- only employees who show that "their right to a reasonable pension" has been forfeited can establish a vested rights violation (*id.* at p. 16).

The petition for review, the twenty amicus letters in support of review,[2] and the five in support of depublication in *Marin Public Employees* argued that these holdings warranted review for reasons ranging

[2] The California Attorney General's Office was also an intervenor in *Marin Public Employees* and supported review of that appellate decision to the extent it challenged the Court's prior rulings on vested rights.

from the evisceration of the longstanding consensus on California vested pension rights law, to the standard-less rule that only the right to a "reasonable" pension is required, to the split created with other district courts of appeal or even within the same district. (See, e.g., *Protect Our Benefits v. City and County of San Francisco* (2015) 235 Cal.App.4th 619, 628-629 ["[w]ith respect to active employees, ... any modification of vested pension rights ... *when resulting in a disadvantage to employees, must be accompanied by comparable new advantages*"] (italics in original).)

Having granted review in *Marin Public Employees,* the Court should also do so here.

B. The Court Of Appeal Decision Reads *Retired Employees' Assn.* As A Break With This Court's Prior Decisions On How Statutory Vested Rights Are Created

Furthermore, the appellate court's belief that *Retired Employees Assn.* requires that an express statutory pension benefit "unambiguously state[] an intent by the Legislature to create a vested pension right" should be reviewed. (Slip op. at p. 9, citing *Retired Employees Assn.,* 52 Cal.4th at p. 1190.) The lower court took *Retired Employees Assn.* to extreme lengths, suggesting that a statute must "promise ... *not to modify or eliminate*" a pension benefit in order to create a vested right. (Slip op. at p. 9.)

Petitioner believes that the language in *Retired Employees Assn.* resulted from the question before the Court in that case: whether *implied* contracts in the public employment context can create vested rights? (52 Cal.4th at p. 1179.) In contrast, two of this Court's most prominent vested rights decisions, *Betts v. Board of Administration* (1978) 21 Cal.3d 859 and *Olson v. Cory* (1980) 27 Cal.3d 532, involved statutes which this Court found conveyed vested contractual rights to employees. Those statutes did not state that a vested right was being created nor had language prohibiting modification or elimination of the benefit; yet this Court unhesitatingly found that modifications to the statutes violated vested pension rights. (See also *Valdes v. Cory* (1983) 139 Cal.App.3d 773, 787 ["explicit language in the retirement law constitutes a contractual obligation on the part of the state as employer"].)

Betts concerned the Legislators' Retirement Law, section 9359.1, subdivision (b), which provided, in pertinent part, when the plaintiff was a legislator that:

> The retirement allowance for [a nonlegislative (sic) member] . . . is an annual amount equal to five percent (5%) of the compensation payable at the time payments of the allowance fall due, *to the officer holding the office which the retired member last held* prior to his retirement, *or* five percent (5%) of the highest compensation *fixed for such office* during the member's last term or any subsequent term prior to his retirement, whichever is greater, multiplied by [years of service credit] . . . .

(21 Cal.3d at p. 862 [italics in original].) This Court noted the "strict limitation" on "modify[ing] the pension system in effect during employment," applying the rule from *Allen v. City of Long Beach* (1955) 45 Cal.2d 128, 131 that "changes in a pension plan which result in disadvantage to employees should be accompanied by comparable new advantages," and concluded that a statutory amendment that replaced a "fluctuating" system of benefit computation with a "fixed" one could not constitutionally be applied to the plaintiff. (*Betts, supra,* at pp. 864-868.) The fact that the statute did not itself prohibit its future amendment did not prevent the petitioner from acquiring "a vested contractual right while employed." (*Id.* at p. 867.) To the contrary, the Court concluded that, having performed services for four years under a statutory scheme that included the pre-amendment version of section 9359.1, that statute, not its amended version, "form[ed] the basis by which petitioner's reasonable pension expectations must be measured." (*Id.* at pp. 867-868.)

Olson v. Cory involved a 1976 statutory amendment to section 68203 which limited annual cost of living increases in judges' salaries. (26 Cal.3d at pp. 534-535.) This Court concluded that the amendment violated two different vested rights: judges already serving a term of office prior to the amendment "had a vested right ... to an annual increase in salary equal to the full increase in the [consumer price index]," which section 68203 had provided before it was amended (*id.* at p. 536), and—most pertinent to this

case—the amendment impaired the vested rights of retired judges by withdrawing rights under the prior version of section 68203 that had been earned while employed. (*Id.* at pp. 537-538.) "Such modification of pension benefits works to the disadvantage of judicial pensioners *by reducing potential pension increases*, and provides no comparable new benefit." (*Id.* at p. 538 [emphasis added].) The protection of potential pension increases in *Olson v. Cory* resonates with this case because of the emphasis the lower court erroneously placed on the right to purchase additional service credit as an unexercised option. (Slip op. at p. 13.)

This Court should use this case to clarify that *Retired Employees Assn.* did not change the longstanding rule that where a statute expressly creates a pension benefit, once "adopted by governing bodies, such agreements are binding and constitutionally protected." (*Olson*, 26 Cal.3d at p. 536.) California courts routinely struck down pension legislation that impaired vested rights established under state and local statutes without requiring promises "not to modify or eliminate" (slip op. at p. 9). (See, e.g., *Board of Administration of the Public Employees' Retirement System v. Wilson* (1997) 52 Cal.App.4th 1109, 1137 [invalidating legislation substituting in-arrears financing of pension system in place of actuarial-based funding]; *DeCelle v. City of Alameda* (1963) 221 Cal.App.2d 528 [modification of pension system precluding pension upon such discharge was detrimental to employee]; *United Firefighters of Los Angeles City v.*

City of Los Angeles (1989) 210 Cal.App.3d 1095 [3% cap on pension cost of living adjustments was unconstitutional as applied to employees hired prior to enactment of charter amendment]; *Pasadena Police Officers' Association v. City of Pasadena* (1983) 147 Cal.App.3d 695 [amendments substantially reducing cost of living benefits of pension plan were invalid]; *Teachers Retirement Bd. v. Genest* (2007) 154 Cal.App.4th 1012 [legislation reducing state's obligation to fund retirees' supplemental benefit maintenance account was invalidated]; *Chapin v. City Commission of Fresno* (1957) 149 Cal.App.2d 40 [ordinance changing method of computing retirement benefits invalid]; *Protect Our Benefits v. City and County of San Francisco, supra,* 235 Cal.App.4th, at pp. 619, 628-629, [invalidating charter amendment which added additional condition precedent to receipt of supplemental cost of living allowances].)

C. The Court Should Grant Review To Reaffirm That Contracts Clause Protections Extend To The Range Of Benefits Offered By The Retirement Law In Effect During Employment

The lower court defined pension benefits too narrowly, as only "deferred compensation that has been earned through the performance of work." (Slip op. at p. 13.) It considered the option to purchase service credit to be "wholly unrelated to actual services provided or work performed" and for that reason not a benefit that "provide[d] state employees with a monetary advantage." (*Id.* at pp. 13-14.)

The lower court misses the forest for the trees. An optional statutory provision which, if exercised, increases an employee's future retirement benefits is unmistakably both a monetary benefit and a pension benefit. The appellate court repeats the mistakes the trial court made in focusing on the short-term cost, instead of the long-term benefit, of exercised rights. And it ignored the statutory requirement that employees had to have at least five years of state service in order to be eligible to purchased additional service credit. (§ 20909.)

The court's fixation with whether or not the benefit was deferred compensation caused it to completely disregard a myriad of California precedents which afford constitutional protection to pension rights that are not in and of themselves deferred compensation. For example, in *Board of Administration v. Wilson,* 52 Cal.App.4th at p. 1137, the court invalidated the governor's attempt to substitute in-arrears financing of a pension system in place of actuarial-based funding. Similarly, in *Teachers Retirement Bd. v. Genest*, 154 Cal.App.4th at pp. 1029-1032, the court of appeal invalidated legislation which reduced the state's obligation to fund retirees' supplemental benefit maintenance account on vested contractual rights grounds. (See also *California Teachers Assn. v. Cory* (1984) 155 Cal.App.3d 494, 506 [holding the state's failure to fund the Teachers' Retirement Fund in accordance with statutory terms constituted an impairment of contract].) In *Frank v. Board of Administration* (1976) 56

Cal. App. 3d 236, 242-244, the court of appeal held that legislation which reduced the range of benefits available to employees who qualified for a disability retirement could not be applied to an existing employee. And in *Protect Our Benefits,* another Division of the First Appellate District held that employees and retirees had a constitutionally-protected vested right to a supplemental cost of living allowance which retirees received when the retirement system's investment returns exceeded projected earnings. (235 Cal.App.4th at p. 622.)[3]

California courts have recognized other non-pension vested benefits, including annual step increases for employees hired on a month-to-month basis (*Youngman v. Nevada Irrigation District* (1969) 70 Cal.2d 240); longevity pay and sabbaticals (*California League of City Employees Association v. Palos Verdes Library District* (1978) 87 Cal.App.3d 135); a five-step plan (*Ivens v. Simon* (1963) 212 Cal.App.2d 177); post-retirement continuation of health benefits (*Thorning v. Hollister School District* (1992) 11 Cal.App.4th 1598).

None of these benefits were deferred compensation. Yet because they were benefits which were in effect when employees provided service, none of those appellate courts had any difficulty finding that they

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[3] Despite *Protect Our Benefits* being the subject of a letter brief and Petitioners' primary focus at oral argument, the court below ignored the decision in its opinion.

were subject to the same protections as the underlying pension benefit itself. The purchase of service credits is, on a practical level, indistinguishable from deferred compensation because it actually results in a change to employees' pension formulas.

This Court should reaffirm that the vested rights doctrine protects an employees' reasonable expectation of the beneficial provisions of the applicable retirement law that exist during the course of his or her public employment. (*Bellus v. City of Eureka* (1968) 69 Cal.2d 336, 350.)

V

CONCLUSION

California vested rights law has been settled for more than sixty years. The decision of the panel below seeks to steer California's vested rights doctrine in a dramatically different direction. This Court should grant the Petition for Review.

Dated: February 8, 2017

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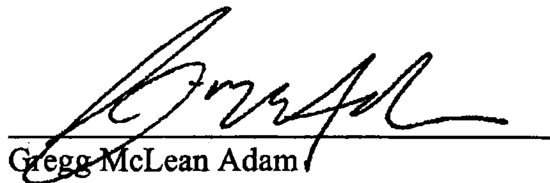
Certificate of Word Count

Pursuant to Rule 8.504(d) of the California Rules of Court, I certify that this brief contains 4,356 words, as determined by the computer program used to prepare the brief.

Dated: February 8, 2017



Gregg McLean Adam

DECISION